



## DEWAN FAROOQUE SPINNING MILLS LIMITED (DFSML)

RATINGS (DECEMBER 2006)

DEWAN FAROOQUE SPINNING MILLS LIMITED

	NEW
<b>ENTITY</b>	
Long Term	BBB+
Short Term	A2

### FINANCIAL DATA

PKR (MLN)

	30-JUN-06	30-JUN-05
Total Assets	1,853.8	1,521.5
Turnover	72.7	-
Net Income	6.8	-
Gross Margin %	22.90	-
ROE %	1.12	-
Net Debt/Equity %	183.54	138.18

### ANALYSTS

Sumaira Fazal  
+92 42 5869504  
sumaira@pacra.com

Shahzad Saleem  
+92 42 5869504  
shahzad@pacra.com

### RATING RATIONALE

#### ASSESSMENT

- The ratings reflect DFSML's relatively low business risk compared to most other textile spinning units in Pakistan. This is mainly an outcome of the company's distinct business model with focus on production of specialty yarn as against regular count yarn, fetching premium pricing. There is also a comparatively low correlation with the domestic textile landscape due to the fact that the company utilizes imported raw material and the bulk of its sales are to export market. Nevertheless, the company faces competition from manufacturers based in other regional countries enjoying economies of scale, and remains exposed to volatility associated with the textile business. At the same time, the company, being in the early stage of its operations, has constrained cash flows mainly due to high finance cost and repayment commitments against long-term borrowings. Meanwhile, the company benefits from its affiliation with a diversified business group.
- Beginning January 2006, freer global trading regime has provided both opportunities and challenges for the textile exporting countries. The textile industry in Pakistan responded by injecting substantial capital investment in upgradation and expansion during the period 1999-2006. While this helped in export expansion during FY06, the momentum could not be sustained in the current financial year with decline both in global market share and in absolute levels reflecting an erosion of Pakistan's competitive edge, particularly in higher value added products. Going forward, companies that are large and vertically integrated, alongwith focus on specialized products are better placed to withstand competitive pressures.
- The management of DFSML, being cognizant of all these developments, is embarked upon a well-conceived business strategy. The company commenced its commercial operations in January 2006. In the initial period, the management focused on achieving full capacity utilization to minimize the drag of fixed costs. As a consequence, margins were slightly lower than the optimum level and there was high concentration in terms of buyers – sales to top 5 customers constituted 72.5% of the total during FY06. Meanwhile, higher financial cost has resulted in nominal profitability for the period.
- Going forward, the management is aggressively pursuing diversification in its customer base with dual objective of reducing concentration and fetching higher prices for its products, thereby further improving margins. However, DFSML would continue to face competitive pressures from other manufacturers in the region. The company is also utilizing support from foreign offices of the Group, one each in Japan and Turkey to target Far East and European markets. The company has relatively low inventory carrying cost. This is because it procures cotton from the international market and does not maintain sizeable inventory levels compared to other spinning units that are based on domestic cotton. However, in the near-term, the company's profitability would remain strained due to debt obligations related to project financing facility. On the longer-term horizon, the management is targeting to double its capacity while placing further emphasis on specialization to the existing product range. In addition, operational diversification, by initiating other activities of the value chain, is under management's consideration. Going forward, the company's overall business strategy is likely to help in achieving higher turnover while keeping profit margins intact. Nevertheless, it will take some time to have substantial positive impact of all these ongoing developments on the company's profitability.
- A major portion of the company's cash flows from operations is currently being utilized for working capital requirements and after repayment of financial charges and taxes, the company's net cash flows remain stressed. Meanwhile, owing to higher financial charges the company's coverages remain thin. The company's cash flows are likely to remain constrained in the near term owing to pending repayment of long-term loan, suggesting a relatively high financial risk. However, with the normalization of the impact of working capital requirements and gradual repayment of the debt, the trend would be corrected. Meanwhile, DFSML continues to get financial support from the Group – PKR 366mln interest free loan at end-Sep06. This has helped the company to comfortably meet its obligations despite constrained cash flows.
- The company's capital structure is strong with adequate gearing level and is likely to be maintained, given the management's stance to maintain its debt-to-equity ratio at a comfortable level, even in the wake of capacity expansions in the long-term.

### PROFILE

- DFSML, established in December 2003 and listed on KSE, is an entity of Dewan Mushtaq Group (DMG). The group family members directly hold around 58% ownership in the company. The Group, an established conglomerate in the country, has interests in synthetic fibers, automotive and allied, sugar and allied, textiles, oil and gas, cement, and general trading sectors. It also enjoys the privilege of having business associations with renowned multinational corporations. The company's plant is located 54km Multan Road, near Phool Nagar Bypass, District Kasur, having production capacity of 28,800 spindles. The company is producing fine count yarn and selling mainly in export market on premium pricing.
- While the group Managing Director, Mr Dewan Yousuf Farooqui, is the designated Chief Executive, the Deputy Managing Director, also a member of Dewan family, enjoys complete operational autonomy in the company. He is an MBA, and has attended various orientations on Production Technology, Production Management, Marketing and Finance. A team of highly qualified and experienced professionals assists the DMD.